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RUEHBK/AMEMBASSY BANGKOK 3454
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RUEHWL/AMEMBASSY WELLINGTON 1585
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TREASURY ALSO PASS TO FEDERAL RESERVE/BOARD OF
GOVERNORS, AND SAN FRANCISCO FRB/TERESA CURRAN

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SUBJECT: Taipei Economic Brief for October 2006

¶1. This cable summarizes selected October 2006 economic events in Taiwan:

- Economic Performance
- Taiwan 4th in US Patents
- Bank Acquisition through Open Market Trading
- Legislature Reviewing 2007 Budget
- Draft CO2 Emissions Law
- R&D Subsidies for SME
- Fourth Nuclear Power Plant
- CME and TAIEX Sign MOU

Economy Performs Well

¶2. Taiwan's economy has performed better than expected in the first nine months this year. Y-o-y export growth accelerated from 12% in Q1 to 18.6% in Q3, highest in the past two years. Import growth also increased from 9% in Q1 to 15% in Q3, highest in the past 21 months. Both export growth and import growth in Q3 were higher than the 7-10% previously estimated by Taiwan think tanks. Export shipments in the next three to six months are expected to grow substantially as orders received in Q3 increased at a double-digit rate, following 21%-growth in the first half of this year. The manufacturing sector's facility utilization rate in Q3 exceeded the 2005 annual average of 80% and its Q3 profit margin surpassed 5% of sales. The Chunghua Institution for Economic Research (CIER) predicted that private investment will grow at 2.9% in Q3 and 4.3% in Q4, highest in the past two years. Taiwan authorities have brought delinquent credit/cash card debt problems under control through a rescheduling mechanism. Private consumption bottomed-out in Q3 and is expected to grow 2.6% in Q4, highest in the past 18 months. Prices were stable in the first nine months; the consumer price index inched up only 0.8%. Prices should remain stable in Q4 as international oil prices are declining in the second half of this

year. Unemployment in September declined from 4.09% in August to 3.96%, lowest for the past six months.

Taiwan 4th in US Patents

13. Taiwan received 5,991 patents from the U.S. Patent and Trademark Office last year, ranking fourth in the world for the seventh consecutive year. Taiwan's ranking moved up to second in terms of patents approved for every one million people of population. Taiwan did especially well in semiconductor, LCD, and information technologies. The number of patents received in semiconductor technology totaled 820, ranking third, behind only the United States and Japan. Taiwan's world ranking was third in information storage, and fifth in such areas as LCD and related technologies, computer hardware and software technology, and computer peripherals.

Bank Acquisition through Stock Market Trading

14. In late September 2006, London-based Standard Chartered Bank (SCB) obtained permission from Taiwan's the Financial Supervisory Commission (FSC) to acquire Taiwan's Hsinchu International Bank (HIB) through open trading in Taiwan's stock market in October. By the end of October, SCB had obtained nearly total ownership in HIB and plans to de-list it from Taiwan's stock market. HIB ranks 27th among Taiwan banks in terms of net worth and has 82 local branches. In 2006 in addition to SCB's acquisition of HIB, 12 major foreign investors have acquired significant percentages of equity in six Taiwan banking institutions through private placement.

Legislature Reviewing 2007 Central Budget

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15. On October 2, the Legislative Yuan (LY) began reviewing Taiwan's proposed 2007 central budget. Expenditures for 2007 will increase 6% from 2006 to NT\$1,663.8 billion (US\$50.4 billion at an exchange rate of NT\$33 per US\$), and the estimated 2007 budget deficit will decline 19% from 2006 to NT\$152 billion (US\$4.6 billion). However, outstanding central public debt will increase from NT\$3,555.7 billion (US\$107.7 billion) in 2005 to NT\$4,040.7 billion (US\$122.4 billion) in 2007. The outstanding debt as a share of GNP in 2007 will increase from 33.1% in 2005 to an estimated 35.2%, still below the statutory limit of 40% and less than the 52.7% in the United Kingdom, 64.1% in the United States, 66.9% in Germany, and 163.4% in Japan. While education, science and culture continue to occupy the largest share of the proposed budget, defense spending will grow 30% to NT\$311.5 billion (US\$9.4 billion), mainly on procurements from the United States.

Draft Law on CO2 Emissions Quotas

16. On September 20, the Executive Yuan (EY) approved a draft bill entitled the Greenhouse Gas Reduction Act, which will impose carbon dioxide (CO2) emission reduction quotas on manufacturing firms in Taiwan. With the bill, Taiwan joins Switzerland and Japan as the only economies mandating greenhouse gas reductions and an emissions quota trading and accounting system. Companies which voluntarily reduce emissions before passage of the law can credit their reduction quotas for trading or for use in future investment projects. Taiwan's Environmental Protection Agency (EPA) will set a national quota on greenhouse gas emissions, while other agencies set quotas for industries that they govern and regulate. The bill will be implemented in stages, starting in 2008 with a registration and verification system for CO2 emissions, followed by determination of emissions quotas and a quota trading system.

R&D Subsidies for Small & Medium Enterprises (SMEs)

17. Under the 2006 Small Business Innovation Research Program, the Ministry of Economic Affairs Department of Industrial Technology (DOIT) will provide 31 SMEs with R&D subsidies of at least NT\$100

million (US\$3 million) for each recipient. The 31 SMEs are principally from electronics, information and telecommunications (IT), machinery, chemicals, biotechnology, and innovation services. SMEs comprise 97.25% of Taiwan's manufacturing sector, but often face a shortage of funding and access to technologies.

Fourth Nuclear Power Plant (FNPP)

18. The state-owned Taiwan Power Company (TPC) denied a recent press report that the FNPP will not start operation in July 2009, as scheduled, because Carrier Engineering failed to honor a bank check in September. TPC is working with the lending bank in an attempt to help Carrier resolve its financial problems, and the scheduled date of completion will remain unchanged.

CME and TAIFEX Sign MOU on Information Sharing

19. On October 27, the Chicago Mercantile Exchange (CME) and the Taiwan Futures Exchange (TAIFEX) signed a memorandum of understanding (MOU) on information sharing. CME is the world's largest and most diverse financial exchange, while TAIFEX is a rising derivatives exchange in the Asia-Pacific Region and the only derivatives exchange in Taiwan. Taiwan has signed similar MOUs with eight other foreign futures exchanges, including with the Osaka Securities Exchange and the Central Mercantile Exchange of Japan

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signed in May 2006.

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